

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re
TRI VALLEY GROWERS,

No. 00-44089 J11
Chapter 11

Debtor./

DECISION RE FMC'S CLAIM FOR ADMINISTRATIVE RENT

FMC Corporation ("FMC") filed a motion seeking adequate protection of certain leased equipment, and allowance of a claim for administrative rent. Following an evidentiary hearing, this court ruled on FMC's claim for adequate protection by order filed September 12, 2000, leaving the issue of administrative rent for subsequent determination after Tri Valley had either assumed or rejected the leases at issue. Thereafter, Tri Valley requested and obtained court authorization to reject the leases pursuant to Bankruptcy Code § 365(a).¹ Therefore, it is now appropriate for the

¹All further section references herein are to the United States Bankruptcy Code, 11 U.S.C. § 101 et. seq.

court to render its decision as to FMC's disputed claim for administrative rent pursuant to § 503(b)(1)(A).² The court will essentially adopt the position taken by FMC.

A. Background

Tri Valley Growers, the above debtor ("Tri Valley"), is a cooperative association organized to process and market fruits and vegetables delivered by its member growers. During the period January 31, 1996 through March 5, 1998, Tri Valley entered into nine leases of canning equipment with FMC. Seven of these were leases of tomato canning equipment, and two were of pear canning equipment. Tri Valley and FMC were also parties to a Parts and Service Agreement under which FMC was required to provide maintenance, parts, and service for certain canning equipment owned by Tri Valley.

The leases were for five year terms, each lease year running from December 1 of any given year to November 30 of the following year. Each lease called for a single annual rental payment by Tri Valley, due on July 1 of each year. July 1 is prior to onset of the canning season, which typically runs from late July through

²Bankruptcy Code § 503(b)(1)(A) provides:

(b) After notice and a hearing, there shall be allowed administrative expenses . . . including –

(1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case.

September, and sometimes, early October.

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Each lease required FMC to provide a specified amount of maintenance and service for the leased equipment, prior to and during the canning season. During the canning season, FMC personnel were required under the leases to be constantly on site at Tri Valley's canning plants to service and maintain the leased equipment, which operated virtually around the clock.

On July 1, 2000, some \$1,880,837 in lease payments came due to FMC. Tri Valley did not make any payment. On July 10, 2000, Tri Valley filed its chapter 11 petition herein.

After the filing, Tri Valley made no use of the equipment at its Thornton, California plant, at which equipment covered by four leases was located. Tri Valley used the equipment covered by the remaining five leases to perform and complete its canning of tomatoes and pears for the year 2000 canning season. The equipment was engaged in actual canning operations for periods ranging from 60 to 71 days.

B. Contentions of the Parties - Rent

The parties agree that FMC is entitled to an administrative priority claim under § 503(b)(1)(A) in respect of all the leased equipment other than the equipment located at Tri Valley's Thornton, California plant. The parties also agree that the leases were at fair market value. They also agree that each year prior to rejection, Tri Valley used the equipment for the processing and canning of fruit only during the year's canning season, and that

over the remainder of the year, usually commencing in January, the equipment was serviced, repaired, and made ready for the next season.

Tri Valley contends that the amount of FMC's administrative claim herein in respect of each lease should be that percentage of the annual rental payment that is attributable to the specific time period over which it used the equipment for its canning operations. For example, the annual rent payment for the pear canning equipment at Tri Valley's plant No. 7 was \$576,481, and Tri Valley used that equipment for canning operations over a period of 60 days. Thus, Tri Valley argues that FMC's administrative claim in respect of such equipment should equal 60/366 of \$576,481, or \$96,952.

FMC contends that under governing case law, the court must determine the objective economic worth of the leased equipment for the period that it was in use by Tri Valley. The equipment is not usable for any economically productive or revenue generating activity other than during the canning season. FMC therefore argues that all of the economic benefit the equipment conferred on Tri Valley must be attributed to the canning season, and thus, that its administrative claim should be in an amount equal to the annual rentals stipulated in the leases, rather than some lesser, prorated amount.

C. Discussion - Rent

A lessor of equipment that is used by a chapter 11 debtor in the operation of its business is entitled to allowance of an administrative claim under § 503(b)(1)(A). In re Thompson, 788 F.2d

560, 562 (9th Cir. 1986). In a case, such as this one, where the debtor has rejected the lease, "[t]he amount of the administrative expense claim is not valued according to the lease term, but under an objective worth standard that measures the fair and reasonable value of the lease." In re Dant & Russell, 853 F.2d 700, 707 (9th Cir. 1988). A presumption exists that the contractual rent rate constitutes a fair and reasonable value, although the presumption may be rebutted. Id.

Here, the parties take no issue with the foregoing principles, but strenuously disagree as to how these principles should apply in this case.

Typically, in lease situations where the above presumption has been applied, courts have allowed lessors' claims for administrative rent based on the annual rent, prorated over the period that the debtor used the leased property, the method urged by Tri Valley here. See, e.g., In re Handy Andy Home Imp. Co., 144 F.3d 1125 (7th Cir. 1998) (proration of real property taxes); In re Tucci, 47 B.R. 328 (Bankr. E.D. Va. 1985). But nothing in the Bankruptcy Code mandates proration. Rather, the controlling factor is the fair and reasonable value to the estate of the leased property, capped by the reasonable value of the lease on the open market. Thompson, 788 F.2d at 563; Dant & Russell, 853 F.2d at 707.

Here, the court believes that the fair and reasonable value of the leased equipment during the entire canning season is the annual rental, without proration. Unlike real property, or equipment that

is usable in some fashion throughout the year, the equipment at issue here does not have any production capability other than during the canning season. Nobody would pay anything in exchange for the use of it before or after, but not during, the canning season. Thus, the economic reality of the leases is that the single annual payment was for use of the equipment during the canning season, and no other period.

Tri Valley raises several arguments why the proration method of calculating FMC's administrative claim is appropriate. First, Tri Valley argues that it customarily used the equipment year-round, not just during the pack, stating that the multi-year leasing arrangements dictate that

a substantial amount of off-season testing, maintenance, refurbishment, and modification of the machinery be done annually. . . . If the off-season service work were not included in the leases, Tri Valley would have to perform such work itself. Thus, with the exception of the period from the end of the pack to the end of the calendar year (the mothball period), Tri Valley effectively uses its processing equipment . . . year-round.

Debtor's Opposition to FMC's Motion, filed December 14, 2000, p. 3. Similarly, Tri Valley argues that some portion of the annual rent it owes must be allocated to the period prior to the filing of the petition herein, and that the amount so allocated must be treated as a general unsecured claim rather than an administrative priority claim.

The court finds these arguments unpersuasive. Tri Valley's possession of the equipment during the off-season for testing,

maintenance, refurbishment, and modification did not confer any economic benefit on Tri Valley, only cost.

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Moreover, Tri Valley admits, and the evidence showed, that a food processor such as Tri Valley cannot lease canning equipment for a canning season of, say, 60 days, at just 16.4% (60/365) of the market rate for a year's lease. Rather the market value for use of canning equipment during one 60-day canning season is 100%, not 16.4%, of one year's rent.

It follows that under the "objective worth" test mandated by Ninth Circuit case law, the "fair and reasonable value" of the leases here corresponded to one year's rent at the contract rate. In re Dant & Russell, 853 F.2d at 707. A contrary holding would present Tri Valley with a large windfall at FMC's expense.

In addition, by having use of FMC's equipment for the entire year 2000 canning season, Tri Valley obtained all of the economic benefit that a lessee of such equipment could possibly obtain in any given year.

Tri Valley cites In re Strauss, 40 B.R. 110 (Bankr. W.D. Wis. 1984) as authority to the contrary. In Strauss, a chapter 11 debtor leased pasture and crop land at the rate of \$50,000 for a specified period of 370 days, payable in unequal installments skewed toward the earlier portion of the lease term. The debtors rejected the lease, but prior to rejection, used the property for a postpetition period of slightly less than three months.

The parties agreed that the lessor was entitled to an administrative priority claim calculated on a per diem basis for the postpetition period during which the debtor used the property, but disagreed as to what the appropriate amount of the daily rent should be. The debtor argued that the daily rent should be calculated by dividing the total rent for the lease term by the number of days in that term. The lessor, however, argued that the property was valueless during the three winter months of December, January, and February, and thus, that the daily value of the property should be determined by prorating the aggregate rent payable under the lease over the nine remaining months of the year. This method of calculation would, of course, produce a higher amount of daily rent to multiply by the number of days that the debtor used the property. The court held in favor of the debtor.

Strauss, however, is easily distinguished. In Strauss, unlike the situation here, the court found that the leasehold did, in fact, have some economic value to the debtor during the three winter months, and thus, that the lease was economically beneficial throughout its term. Id. at 112.³ In any event, to the extent that Strauss is inconsistent with the conclusion expressed here, the

³The court found, among other things, that some corn fodder could remain for harvesting during the winter months. The court also mentioned the fact that 30% of the annual rent was payable "in or just following the winter months" to support its finding that the lease afforded value to the debtor during the winter months Strauss, 40 B.R. at 112.

court declines to follow it.⁴

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For the foregoing reasons, the court holds that FMC is entitled to an administrative claim for rent under the five leases in an amount equal to the amount of the contractual annual rent payable thereunder. The court also holds that FMC is not entitled to any administrative priority claim in respect of the leases of the equipment at Tri Valley's Thornton, California cannery.

D. Taxes; Parts and Service Agreement

The court holds that the portion of FMC's administrative priority claim attributable to taxes payable by Tri Valley under the leases (other than Thornton), and the benefits that Tri Valley obtained under the Parts and Service Agreement, should be calculated in the fashion set forth in the court's order filed September 12, 2000.

E. Conclusion

The court requests FMC to prepare a proposed order liquidating the amount of its administrative claim in accordance with the foregoing and the supplemental papers it filed January 2, 2001, updated as appropriate. Pursuant to the court's order filed September 12, 2000, the amount of FMC's administrative priority claim must be reduced by the amounts that Tri Valley paid FMC as

⁴The only other case cited by Tri Valley to support its proration argument, In re Norton, 112 B.R. 932 (C.D. Ill. 1990), involved entirely different issues, and is of no assistance here.

adequate protection thereunder.

Before it submits a proposed order to the court, FMC should first serve a copy on Tri Valley, and allow Tri Valley not less than 15 days to review the figures. In the event of a dispute as to the form of order, the parties should attempt to resolve it on a consensual basis, including the furnishing of information, before any order is presented to the court.

In the event that the parties are unable to achieve a consensual resolution, they may submit their conflicting orders to the court, with a short explanation as to why they disagree, and the court will resolve the dispute in such manner as is appropriate.

Dated: January 30, 2001

Edward D. Jellen
United States Bankruptcy Judge